

The federal systems of Switzerland, Germany, and the European Union . . . all provide that constituent states, not federal bureaucracies, will themselves implement many of the laws, rules, regulations, or decrees enacted by the central “federal” body. . . . They do so in part because they believe that such a system interferes less, not more, with the independent authority of the “state,” member nation, or other subsidiary government, and helps to safeguard individual liberty as well.

—Justice Stephen Breyer, *Printz v. United States* (1997) (dissenting opinion)

The fact is that our federalism isn't Europe's.

—Justice Antonin Scalia, *Printz v. United States* (1997) (majority opinion)

Amerika, du hast es besser.

—Johann Wolfgang von Goethe, *Wendts Musen-Almanach* (1831)

Cooperation Does Not Work

By Michael S. Greve

American federalism is in practice a cooperative federalism: state and local governments implement federal programs, typically with federal financial assistance. A broad political and scholarly consensus sustains that institutional arrangement. Cooperative federalism is, however, a terrible idea, regardless of the terms of cooperation. Federalist Outlook No. 3 pays a visit to Germany, a citadel of cooperative federalism and, consequently, of economic malaise and civic disaffection. Patient readers will receive what the authors of the Federalist Papers, concluding their inspection of European federations, called a “melancholy and monitory lesson” on the vices of federalism, wrongly conceived. Federalist Outlook No. 4 will address the sprawl of cooperative federalism here at home.

I Love You, You Love Me

Real federalism's lifeblood is institutional competition. The U.S. Constitution envisions political conflict and functional separation among independently constituted states and national institutions.

Contemporary politics and public debate are to that vision what Barney the Dinosaur is to the World Wrestling Federation: federalism, it is not so much argued as presumed, should be consensual and cooperative. The federal government supplies 100,000 police officers, 100,000

teachers, and numberless nannies. Grateful states, cities, and counties employ those faithful servants, whereupon the feds volunteer to put roofs over their heads. (A federal school construction bill is pending as this goes to press. First dibs on the cash will go to the twenty-three elementary schools that somehow missed out on a presidential aspirant's recital of *The Very Hungry Caterpillar*.) The parties' and the presidential candidates' programs on environmental protection, education, welfare, and crime prevention all rest on the common ground of cooperative federalism: Let the feds provide money and standards (“tough standards,” when it comes to education). Let states, cities, and school boards experiment and implement.

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Yes, the politicians disagree on funding levels and the stringency of federal grant conditions. Cooperative federalism's devil, however, is not in its details but in its design and dynamics. Cooperative federalism in whatever shape or form undermines political transparency and accountability, diminishes policy competition, and erodes self-government and liberty. It is a perversion, not an extension, of the constitutional scheme and its institutional logic.

For reasons to be explained, it is not altogether clear what and how much can be done to replace government cooperation with competition. A necessary first step, though, is to crack the consensus on cooperative federalism and to make sober citizens wretch at the thought. We begin that task in Germany—a country that, though traditionally proud of its cooperative federalism, is now conducting a vigorous debate about its defects.

Federalism, German-Style

Germany is not a happy country these days. Its political leaders and opinion elites lament the country's lagging economic performance, as measured by anemic growth rates and sustained high unemployment. Despite a general consensus that the source of Germany's economic malaise lies in punitive taxes and in labor and welfare laws that have made German labor the most expensive in the world, those regimes seem immune to reform. The high of reunification was followed by recriminations and regrets over the exorbitant costs. Even without a Robert Putnam to ring the alarm over *Fussball Allein*, the Germans worry greatly over civic disaffection [*Politikverdrossenheit*], which finds expression in voter disengagement and, more troubling, in growing support for radical parties, left and right.

Germany's grumpiness is nothing new, good cheer never having been a hallmark of her politics. What is new and noteworthy is that academics, opinion leaders, and politicians have come to tag an unexpected suspect as the source of Germany's problems—cooperative federalism.

Unlike our federalism, Germany's federalism is cooperative by constitutional design. Under the German Constitution, originally enacted in 1949 as the "Basic Law" of the Federal Republic of Germany, the federal government administers a few institutions, such as the armed forces and the Bundesbank. On the other hand, schools and the local police are left to state and local governments. The general constitutional rule,

however, is that the *Laender*—that is, the states—administer federal statutes and regulations "as their own affair" [*als eigene Angelegenheit*] (Article 83 of the German Constitution) or, in a few cases, on behalf of the federal government [*im Auftrag des Bundes*] (Article 85). The *Laender* participate as political entities in the formation of federal policy: federal statutes that substantially affect the states (especially their budgets) require the assent of the Bundesrat, an assembly of the states' delegations. But the states' "independent authority" lies, as Justice Breyer correctly observes, in their administrative autonomy. The *Laender* enjoy certain protections against direct federal interference in the administrative process; on the other hand, they must do the administering on their own nickel.¹

Independent administration, if taken seriously, poses a risk that the country might disintegrate into a confederation. To prevent that outcome, the German Constitution matches independent state administration with a mechanism to ensure that the *Laender* will toe the federal line. That mechanism is money.

The operational core of German federalism is the Financial Constitution [*Finanzverfassung*]. It is contained in Articles 104–109 of the German Constitution, encompassing thirty long, often amended, and, to all but a few experts, impenetrable paragraphs. The constitutional principle is general revenue sharing: personal and corporate income taxes as well as value-added taxes raised in the states—all told, some 75 percent of the total tax take of government at all levels—are shared among the federal government, the *Laender*, and the local governments. The states' share is subject to a constitutional scheme of "horizontal financial compensation": revenue-rich states must support poorer states so as to achieve an "assimilation of living conditions" [*Angleichung der Lebensverhaeltnisse*] in the various states. In addition, the federal government may use its own funds to supplement the poorer states' budgets.

The Financial Constitution bears enormous institutional weight. The vertical division of funds among the federal and the subordinate governments must be calibrated to prevent one from becoming parasitic on the other(s). Horizontal compensation must be sufficient to produce consensus and solidarity among the *Laender*—and yet not so extensive as to prompt the donor states' resentment. Those conflicting and crosscutting demands have rendered the Financial Constitution and its implementing legislation a permanent

work in progress—the subject of ceaseless legislative revision, constitutional amendment, and litigation.² Germany's Constitutional Court has issued four comprehensive rulings on the matter. In its most recent decision of November 1999, the court found that the existing revenue-sharing laws and regulations bear no rational relation to the constitutional requirements. Reluctant to void an arrangement that is, after all, central to the operation of German federalism, the court gave the politicians two years to fix the system.³

Cooperative Federalism's Discontents

The essence of cooperative federalism, as just seen, is intragovernmental conflict, both vertical and horizontal, over a pot of money. And yet, for well over three decades, German federalism generally produced an outward appearance of the consensus for which German politics is famous. Why?

The short and simple answer is: tax increases. Hold revenues constant, and the distributional conflicts will soon become unmanageable. A growing revenue pie, in contrast, makes it possible to produce periodic intergovernmental equilibrium points—by growing government at *all* levels.⁴ Cooperative federalism requires government growth.

At the same time, cooperative federalism facilitates government growth. Intragovernmental cooperation means shared political responsibility, which in turn means that citizens cannot easily finger the culprits for government bloat and train wrecks, much less hold them to account. It may be that democratic governments of all stripes—unitary or federalist, competitive or cooperative—tend toward expansion. But if one had to invent institutions that will reliably maximize government, cooperative federalism would be a splendid choice.

As the intragovernmental conspiracy cheerfully moves outward and upward on the Laffer curve, expanding political commitments produce further interdependencies and conflict. The ineluctable tendency is toward a pathology that German scholars and highbrow journalists call *Politikverflechtung*, meaning a political meshing or entangling. Among the symptoms are lack of transparency, civic discontent, the stifling of political competition, and political paralysis.

Lack of Transparency and Civic Discontent. As government grows and the range of cooperative arrangements

expands, transparency, accountability, and responsibility diminish exponentially. Germans know that their government claims an ever larger share of their income, but they no longer know why or for what.

Stifling of Political Competition. Germany's Financial Constitution—particularly its commands to harmonize living conditions and to equalize financial resources across the various states—diminishes every state's incentive to improve its lot by providing a favorable economic climate. The Financial Constitution systematically punishes wealthy, successful states, while rewarding the basket cases.

Political Paralysis. Cooperative federalism does not so much enhance the states' autonomy; rather, it rewards the most intransigent participant. In the end, every player becomes a holdout, and reform becomes impossible. Scholars, journalists, and leading politicians have tagged cooperative-federalist arrangements as a principal cause of Germany's *Reformstau* [reform jam, as in "traffic jam"]—that is, Germany's inability to adjust its institutions and policies to the demands of a modern, global economy.⁵

In early summer, to the acclaim of the international financial markets, the Social Democratic government managed to enact a corporate tax reform that will modestly reduce tax rates and allow tax-free sales of corporate stock holdings and thus facilitate their transfer from German banks into the hands of investors who have a higher and better use for the assets. As if to illustrate the pathology of cooperative federalism, the tax reform was accomplished through a dramatic break with the operating principles of the Financial Constitution. Anticipating opposition from a majority of *Laender* in the Bundesrat, Chancellor Gerhard Schroeder took the unprecedented step of purchasing the votes of three fence-sitting *Laender* delegations by promising them several hundred million marks in federal assistance outside the bounds, and arguably in derogation, of the Financial Constitution.

The Competitive Alternative

Many Germans, including the Christian Democratic opposition and the *Frankfurter Allgemeine Zeitung*, have complained bitterly about Mr. Schroeder's extraconstitutional tax escapade. Others have cheered the long-overdue reform and its proximate cause—a chancellor with the authoritarian streak of Third Way politicians across the globe. Broad consensus exists, however, that

occasional policy improvisation is no substitute for institutional reforms that would produce a more open, competitive federalism.

That insight does not come easily to a country accustomed to consensus. The past decade, however, has made the need for more competitive institutions inescapable.

- Luxembourg and the Saarland are two adjacent, bathmat-sized jurisdictions in the heart of Western Europe, both once heavily dependent on the region's steel and coal production. Luxembourg has turned itself into Europe's Delaware—a prosperous haven for banks and investors. The Saarland, in contrast, has become an impoverished backwater, whose main export is its citizens. Some 25,000 commuters work in the Saarland but live in neighboring France to escape Germany's confiscatory taxes. Tax flight—of all places, into France—is a sure sign of trouble at home. It has dawned on the politicians that the Saarland's travails, and Luxembourg's good fortune, have to do with the fact that Luxembourg has had the energy and the freedom to compete, whereas the Saarland is locked into Germany's federalism cartel.⁶
- Reunification put Germany's political institutions, and especially a Financial Constitution designed for a cartel of approximate equals, under enormous strain. Political competition would have provided an attractive solution: Had the new *Laender* remained exempt from West Germany's labor and welfare laws, capital and jobs would have moved east and thus would have facilitated a reasonably prompt economic integration. Instead, Chancellor Kohl's Christian-Democratic government inflicted those entitlements—unsustainable even in productive West Germany—on the East and showered that economic wasteland with subsidies. Over 80 percent of revenue-sharing proceeds wind up there. In addition, the government legislated an income-tax surcharge to pay for East Germany's reconstruction. (The surtax is not called a tax but a “contribution” so as to remove it from the constitutional revenue-sharing arrangements. Otherwise, even poor states in the old West would have turned into net payers.) Jobs and capital still went east—all the way to Poland and the Czech Republic, while East Germany's youthful unemployed found

occupation, in a manner of speaking, as neo-Nazi skinheads.

The lessons have not been lost. Academic experts are calling for institutional and constitutional reforms that would produce a more competitive federalism.⁷ Proposals to that effect have been taken up by one political party (the Free Democrats) and by a handful of state governments.⁸ In the latest round of litigation over the Financial Constitution, the plaintiff-states urged the Constitutional Court to pay heed to the perverse-incentive effects of a compensation-oriented, revenue-sharing arrangement. “Competitive federalism” has found its way into the political lexicon and into public debate.⁹

No Way Out?

Germany's debate over competitive federalism comes alarmingly late in the day, long after shocks and dislocations (especially reunification) that should by all rights have led to fundamental reforms. While existing jurisdictional competition provides a learning experience, it also produces ham-fisted, statist responses. For instance, the German government has conducted a dragnet operation against thousands of citizens with investments in Luxembourg, where the proceeds are hidden—though not exempt—from German tax laws. (The government obtained the transfer records not from Luxembourg, where they are guarded by bank secrecy laws, but by threatening the customers' German banks with prosecutions for aiding and abetting tax evasion.) While thus endearing itself to prosperous taxpayers, the German government is also pressuring the European Community to “harmonize” the tax treatment of financial instruments, the better to wipe happy little Luxembourg's experiment off the map. Cooperative federalism's first choice is not to reform itself but to export its distortions.

Moreover, Germany's cooperative federalism rests on very old and stubborn political traditions—in fact, the same traditions that horrified the authors of the *Federalist Papers*. (*Federalist Papers* 19 and 20 contain an instructive account of the political and financial dynamics of European confederacies that purport to be countries.) The constitutional dimension of the federalism debate ensures that it will be dominated by legal scholars, most of whom believe that competition has

no place in law and government. Unlike private actors, the hoary theory goes, government will automatically act in the public interest.

The revision of the revenue-sharing system, necessitated by the *Bundesverfassungsgericht's* November 1999 ruling on the Financial Constitution, provides the best and most urgent opportunity for procompetitive reforms. Unfortunately, however, the court roundly ignored the plaintiff-states' arguments concerning the anticompetitive effects of the existing regime. Instead, the court instructed the federal legislature to design a new, fair, and rational compensation scheme behind, so far as possible, a Rawlsian "veil of ignorance"—that is, without regard to the immediate fiscal effects or the various governments' actual political interests. From the politicians' original position shall emerge a law that meets the criteria of practical reason and, moreover, binds all future politicians.¹⁰ The politicians will do all that because doing so is their duty. Forget politics and economics. Immanuel Kant, meet the welfare state!

Finally, the competitive reform impulse is likely to disappear in what scholars have called the "trap of cooperative federalism."¹¹ Federalism reform, the *Frankfurter Allgemeine Zeitung* has editorialized, is not hard to figure out: segregate revenue sources among states, localities, and the federal government; segregate the governments' tasks and functions; put competition in play. But a tangled, cooperative government apparatus is probably incapable of acting on that insight.¹² The institutional structures and dynamics that make competitive reform imperative also render it impossible.

In one sense, though, Germany is ahead on the competitive federalism curve: her politicians, academics, and opinion leaders are conducting a serious debate about cooperative federalism, its ill effects, and the need for political competition. Our own politicians, in contrast, are busier than ever inventing federally funded programs to have state and local officials mow our lawns and tuck in our kids. Their acts of statesmanship are accompanied by a unisonal burble about the glories of cooperation and devolution.

All that will change, or so one hopes, with the next issue of the *Federalist Outlook*.

Notes

1. For example, the feds will pay the direct costs of child-support payments but not the cost of administering them. The

protections are contained in Articles 84 and 85 of the German Constitution; the financial obligations, in Article 104a(2), (5).

2. The continuously revised and amended Financial Constitution represents the latest chapter in modern Germany's unending effort to find a satisfactory institutional arrangement between the *Laender* and the national government. Each successive arrangement was criticized as rendering one overly dependent on the other. (A famous phrase, "*Reich als Kostgaenger der Laender*," meaning the Reich as the states' parasite, was coined by Bismarck.) A mind-numbingly thorough account is Juergen W. Huidien, *Der Bundesstaatliche Finanzausgleich in Deutschland: Geschichtliche und Staatsrechtliche Grundlagen* (1999).

3. In other words, the revenue-sharing system is unconstitutional in principle, but not just yet. The court's decision and opinion, 2-BvF-2/98 (November 11, 1999), appear at <http://www.bverfg.de>.

4. Aaron Wildavsky observed the same tendency, with respect to American cooperative federalism, in his spirited essay "Fruitcake Federalism or Birthday Cake Federalism?" in Wildavsky, *Federalism and Political Culture*, edited by David Schleicher and Brendon Swedlow (Transaction, 1998), p. 55.

5. See, for example, Fritz W. Scharpf, "Die Politikverflechtungsfalle," *Politische Vierteljahresschrift*, vol. 26 (1985), p. 323; and, more recently, Thomas Koenig's trenchant observations on "Regieren im Deutschen Foederalismus," *Aus Politik und Zeitgeschichte*, vol. B13/99 (1999), p. 24.

6. Thomas Christmann, "Vom Finanzausgleich Zum Massstaebesetz," *Die Oeffentliche Verwaltung*, vol. 53, no. 8 (April 2000), p. 321.

7. See, for example, Adrian Ottmad and Edith Linnartz, *Foederaler Wettbewerb statt Verteilungsstreit: Vorschlaege zur Neugliederung der Bundeslaender und zur Reform des Finanzausgleichs* (1997); Thomas Apolte, *Die Oekonomische Konstitution Eines Foederalen Systems: Dezentrale Wirtschaftspolitik zwischen Kooperation und Institutionellem Wettbewerb* (1999); and Karl-Heinrich Hansmeyer, "Federalism in Europe—Problems and Questions for Research," *Beiheft der Konjunkturpolitik*, vol. 49 (1999) (English abstract available at <http://smith.diw.de/Konjunkturpolitik/english>).

8. For the Free Democratic Party, see Friedrich Naumann Stiftung, ed., *Wider die Erstarrung in Unserem Staat—Fuer die Erneuerung des Foederalismus* (1998). For state governments, see Christmann, "Vom Finanzausgleich zum Massstaebesetz," p. 315.

9. *Competitive* [*kompetitiv*] is not actually a German word. But since it has no equivalent measuring under three inches in print, the Germans have adopted the Anglicism. See, for example, Horst Siebert, "Mehr Standortwettbewerb beim Finanzausgleich—Ein Kompetitiver Foederalismus Gehoert

zur Modernisierung Deutschlands,” *Frankfurter Allgemeine Zeitung*, August 8, 2000, p. 17.

10. See the court’s opinion, 2-BvF-2/98 (November 11, 1999), p. 282 (Internet version at <http://www.bverfg.de>) (citing John Rawls, *A Theory of Justice*). The court’s call for a quasi-constitutional revenue-sharing superlaw is endorsed, with reservations, by Hans Peter Bull and Veith Mehde, “Der Rationale Finanzausgleich—Ein Gesetzgebungsauftrag Ohnegleichen,” *Die Oeffentliche Verwaltung*, vol. 53, no. 8 (April 2000), p. 306. It is rejected, on constitutional grounds, by Joachim Linck,

“Das ‘Massstaebegesetz’ zur Finanzverfassung—Ein Dogmatischer und Politischer Irrweg,” *Die Oeffentliche Verwaltung*, vol. 53, no. 8 (April 2000), p. 325.

11. Martin T. W. Rosenfeld, “The Present Problems and the Future of Cooperative Federalism in Germany,” *Beiheft der Konjunkturpolitik*, vol. 49 (1999) (English abstract available at <http://smith.diw.de/Konjunkturpolitik/english>) (visited August 31, 2000).

12. “Kopf Hoch, Fuersten!” editorial, *Frankfurter Allgemeine Zeitung*, August 12, 2000, p. 11.